

REPORT OF

TARGET MARKET CONDUCT EXAMINATION

OF

**SUN LIFE ASSURANCE COMPANY OF CANADA –
UNITED STATES BRANCH
TORONTO, ONTARIO, CANADA**

AS OF

DECEMBER 31, 1996

The Honorable Mike Kreidler
Washington Insurance Commissioner
Insurance Building
PO Box 40255
Olympia, Washington 98504-0255

Dear Commissioner Kreidler:

Pursuant to your instructions and in compliance with the statutory requirements of RCW 48.03.010, I have examined the corporate affairs and market conduct of:

Sun Life Assurance Company of Canada – United States Branch, NAIC #80802
150 King Street W.
Toronto, Ontario, Canada M5H 1J9

hereafter referred to as "the Company" or "Sun Life". The following report is respectfully submitted.

Scope of Examination

The examination was performed in compliance with the provisions of Washington insurance laws and regulations. The market conduct review followed the rules and procedures promulgated by the Office of the Insurance Commissioner (OIC) and the National Association of Insurance Commissioners (NAIC). The examination covered the period of January 1, 1992 through December 31, 1996. The scope of this examination was limited to Marketing and Sales Practices, Complaint Handling and Replacement Activity.

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EXAMINATION REPORT CERTIFICATION

This examination was conducted in accordance with the Office of the Insurance Commissioner and National Association of Insurance Commissioners market conduct examination procedures. This examination was performed by Leslie A. Krier, Alan A. Hudina, and Nancy L. Barnes who participated in the preparation of this report.

I certify that the foregoing is the report of the examination, that I have reviewed this report in conjunction with pertinent examination work papers, that this report meets the provisions for such reports prescribed by the Office of the Insurance Commissioner, and that this report is true and correct to the best of my knowledge and belief.

Leslie A. Krier, AIE, FLMI
Chief Market Conduct Examiner
Office of the Insurance Commissioner
State of Washington

FOREWORD

This target market conduct examination report is by exception and additional practices, procedures and files subject to review during the examination were omitted from the report if no improprieties were indicated. Throughout the report, where cited, RCW refers to the Revised Code of Washington and WAC refers to the Washington Administrative Code.

SCOPE

SITUS

This examination was a Level Two Target Market Conduct Examination. It was conducted off site at the OIC office in Seattle and at the Company's offices in Boston, Massachusetts.

TIME FRAME

The examination covered the company's operations for the period January 1, 1992 through December 31, 1996.

METHODOLOGY

Sampling Standards

In general the sample for each test utilized in this examination falls within the following guidelines:

92% Confidence Level
+/- 5% Tolerance

REGULATORY STANDARDS

Samples are tested for compliance with standards established by the OIC. The tests applied to sampled data will result in an error ratio, which determines whether or not a standard is met. If the error ratio found in the sample is, generally, less than 5%, the standard will be considered as "met." The standard for agent licensing and appointment is not met if any violation is identified. This will also apply when all records are examined, in lieu of a sample.

For those standards, which look for the existence of written procedures, or a process to be in place, the standard will be met based on the examiner's analysis of those procedures or processes. The analysis will include a determination of whether or not the company follows established procedures.

HISTORY OF THE COMPANY TERRITORY OF OPERATIONS MANAGEMENT

Sun Life Assurance Company of Canada – United States Branch (Sun Life) was admitted to the State of Washington on August 29, 1924. Sun Life is licensed for life and annuity products in Washington. Their taxable premium volume in 1996 in Washington was \$17,117,909. The Company had 2,280 policies issued in Washington during the exam period. As of the examination date they had 98 agents licensed in Washington.

A Board of Directors governs the Company. The board members are:

Dian N. Cohen	Professor M. Colyer Crum
Stanley H. Hartt	The Honourable Donald S. Macdonald, P.C., C.C.
John M. MacLeod	Angus A. MacNaughton
John D. McNeil	Bertin F. Nadeau
Ronald W. Osborne	Alfred Powis
Sir Bob Reid	Donald A. Stewart
William W. Stinson	W. Vickery Stoughton
David G. Vice	Jeannine Guillevin Wood

For operations in the State of Washington, the administrative records for the Company were housed in four (4) locations, the Company's headquarters in Wellesley Hills, Massachusetts, two (2) warehouses in Massachusetts and the mainframe policy administration system in Willowdale, Ontario, Canada (the Atria Facility).

The Company utilizes a variety of storage methods for policy records. Applications for coverage and related underwriting documents are generally retained in paper form. Other policy records, such as policyholder correspondence and billing notices, have been maintained in paper form, microfiche and an electronic storage medium referred to as Computer Aided Retrieval (CAR). The Company ceased recording new policy records on microfiche in early 1994. The CAR system was implemented in March of 1994. Policy records are also maintained on the Company's policy administration computer system. The Company's policy administration system in use prior to April 1, 1994 was the Advanced Life Insurance System (ALIS). The ALIS system is located at the Atria facility. This system was used for policy administration by personnel located at the Company's US Branch Headquarters in Wellesley Hills. In 1994, the Company began to convert policy administration records to a new system referred to as SOLAR. This system is also located at the Atria facility.

Affiliates and Subsidiary Companies

There are no affiliates or subsidiary companies whose operations are within the scope of this examination.

MARKETING PLAN

The Company provided marketing plans for each of the five (5) years covered by this examination. Common themes throughout the plans included: proposed revisions in the tax treatment of annuities, the entry of banks into the market place and redesign of the Company's service center. There were no references to vanishing premium policies, replacement or exchange programs, nor any other indicators of possible churning activities.

STANDARD 1 - The Company's marketing plan does not contain references to vanishing premium policies, replacement programs, exchange programs, or other indicators of possible churning activities.

RESULT: The Company met this standard.

ADVERTISING FILE/ILLUSTRATIONS

Advertising

The Company's advertising file was reviewed pursuant to WAC 284-23-090. The advertising file contained all advertising materials as statutorily defined. The Company provided a syllabus showing 1,669 pieces of advertising material in use during the exam period. Fifty (50) items were selected based upon the examiners' perception of relevance of the material to the scope of the exam. Of these 50 items reviewed, two (2) were agent designed and had been approved by the Company.

The Company stated that all producer generated advertising material "that is expected to be used directly or indirectly with policyholders, prospects or the general public to be approved by Sun Life's Publication Committee." This procedure requires the producer to submit the proposed material for approval. The materials are screened for compliance with applicable insurance regulations, as well as applicable state and federal securities regulations. Additionally, the material is reviewed for "clarity, accuracy, and overall appropriateness of their presentation."

The Company was unable to provide any formal, written audit reports for the examination period. However, discussions with Company personnel indicate that a variety of training and compliance visits occurred during the examination period. Home office personnel periodically visited with the independent distributors and career agencies that had contracted to sell their products. These visits included discussions of a variety of matters, including product training, marketing, advertising, regulatory compliance, and business plans. In mid-1996, the Company's Compliance Department began a series of field training and compliance visits in order to review compliance and market conduct topics, including advertising, complaints, replacements, and licensing.

STANDARD 2 – All agent or vendor produced training materials were controlled by the Company and the Company actively audited use of these materials.

RESULT: Although the Company could not provide formal audit reports, the Company has demonstrated that they met this standard.

Subsequent Event: Since 1997, the Company has implemented a General Agency Examination Program to conduct internal audits. The procedures provided were reviewed and are quite extensive. The areas reviewed in this program include compliance manuals, agent/broker contracts, software, complaints, replacement activity, underwriting, confidentiality requirements, advertising, and licensing.

Illustrations

The Company provided a CD which contained 22 versions (updates, new products) of illustration software. Numerous illustrations were generated and most were reviewed on screen as the print commands were not compatible with the available printer. The following observations were consistent throughout the data input process:

- The system would not allow an interest rate to be entered that was outside the range established for the product. The warning message “Invalid Input, Please Re-Key” was displayed. One could not tab past nor enter additional data until a proper rate was entered.
- The more current versions displayed an acceptable range of interest rates and would not allow input above or below the displayed range.
- Entering an acceptable rate and then going back to edit that rate resulted in the same warning message indicated above.
- The displayed illustration could not be changed.

STANDARD 3 – The advertising file contained copies of all advertising material as statutorily defined, including copies of agent created advertising material, WAC 284-23-090 and WAC 284-23-020.

RESULT: The Company met this standard.

STANDARD 4 – Advertising materials complied with Washington Advertising Regulations, WAC 284-23-010 through WAC 284-23-080.

Number of advertisements	1,669
Number of advertisements reviewed	50
Number in violation	0
Percent in violation	0 (within 5% tolerance limit)

RESULT: The Company met this standard.

AGENT ACTIVITY

Training Bulletins

Included in the listing of marketing and training bulletins were four (4) publications that were listed as periodic. These publications were: The GA (General Agent) Update, Brokerage Exchange, Manager's Reports and US Field News. As there was not a topical index available for each publication, sample copies were requested. The GA Update was primarily a corporate directory of people and departments, agency rankings, and underwriting issues. Brokerage Exchange consisted of listings of conferences, meetings, and new products. The Manager's Report dealt almost exclusively with paid premium reporting. It was not deemed necessary to view additional examples of these publications. US Field News contained articles on field underwriting, commentary on the past years' performance and goals, persistency, and various press clippings. Six other random issues were requested and reviewed. There were no references in the materials that would encourage replacement of existing policies or special funding programs.

STANDARD 5 - Agent communications did not encourage replacement of existing internal or external policies, special funding programs or other indicators of churning activity.

RESULT: The Company met this standard.

Audits

The Company was unable to provide any formal, written audit reports for the examination period. However, discussions with Company personnel indicate that a variety of training and compliance visits occurred during the examination period. Home office personnel periodically visited with the independent distributors and career agencies that had contracted to sell their products. These visits include discussions of a variety of matters, including product training, marketing, advertising, regulatory compliance, and business plans. In mid-1996, the Company's Compliance Department began a series of field training and compliance visits in order to review compliance and market conduct topics, including advertising, complaints, replacements, and licensing.

STANDARD 6 – The Company conducted regular audits of agent activities through regular branch or agency office audits and visits.

RESULT: Although the Company could not provide formal audit reports, the Company has demonstrated that they met this standard.

Subsequent Event: Since 1997, the Company has implemented a General Agency Examination Program to conduct internal audits. The procedures provided were reviewed and are quite extensive. The areas reviewed in this program include compliance manuals,

agent/broker contracts, software, complaints, replacement activity, underwriting, confidentiality requirements, advertising, and licensing.

Agent Training Materials

The Company provided a syllabus of Marketing and Training documents that contained 69 items. Twenty (20) of these were chosen for review based upon their perceived relevance to the scope of the examination. Included in the items requested and reviewed was the Field Compliance Manual. Part 3 of this manual addresses replacement in several sections entitled “Why is Replacement Bad for the Policyholder?”, “Unethical Replacement,” “Churning”, “Twisting”, “Is Replacement Ever Appropriate?”, and two (2) sections on Sun Life’s replacement requirements and consequences of violations. The review was unremarkable for any references encouraging replacement of existing policies or special funding programs.

Additionally, the Company provided a copy of their software program, Spirit, which was an agent’s tutorial on Company products. The exam relevant copy could not be executed and was no longer supported; however, the Company provided a current version that included a substantial glossary of terms and policy provisions and applications.

STANDARD 7 – Training material for both new and existing agents in use during the examination period complied with Washington Statutes and Regulations, WAC 284-23-010 through WAC 284-23-130.

Total Number of Training Materials	69
Pieces reviewed	20
Pieces not in compliance	0
Percent not in compliance	0% (within 5% tolerance limit)

RESULT: The Company met this standard.

Agent Contracts

The agent contracts were reviewed. There were three (3) types: Career Agency, Brokerage General Agency and National Account Distribution. Among these three (3) types, there were 29 different contracts and compensation schedules. Nothing in the contracts or compensation schedules contained language that would tend to encourage internal replacements. All conversions and replacements required commission adjustments, as did withdrawals within specified time limits. In support of this position the Company provided excerpts from its Agency Management Guide dated July 1990 which provided for commission adjustment “within 3 months before or 12 months after the date of an application for a new policy.” Additionally, a memorandum dated May 16, 1996 to all sales representatives states, “The replacement of existing life insurance business is generally not in the best interests of our policyholders.” The memo continues by addressing the commission adjustments that would be made in given situations and is deemed a restatement of “Sun Life’s policies and procedures regarding commission payments on internal replacements.”

In the Career Agency System, the agents worked out of sales offices referred to as branch offices located throughout the United States. Branch managers at the local level managed the branch offices. Management personnel within the Company's Agency Department located at Wellesley Hills had overall responsibilities relative to these branch offices.

Subsequent Event: In 1997, the Career Agency System was disbanded.

In the Brokerage General Agency, the Company contracted with independent general agencies, and the general agencies recruited and contracted with independent producers to solicit the Company's products. Management personnel within the Company's Brokerage Department located in Wellesley Hills had overall responsibilities relative to recruiting and contracting with the independent general agencies.

The reporting system for National Account Distribution was similar to that described above for the Brokerage General Agency with the Company contracting with investment firms and banks to market the Company's products. These firms then employed or contracted with licensed producers engaged in the solicitation of life insurance products. Management personnel within the Company's Brokerage Department located in Wellesley Hills had overall responsibility relative to recruiting and contracting with the national account firms.

STANDARD 8 – Agent contracts and commission schedules did not contain language that encourages internal replacements.

RESULT: The Company met this standard.

WASHINGTON AGENT OVERSIGHT & DISCIPLINARY PROCEDURES

The Company essentially provided three (3) sets of Disciplinary Action procedures, one set for each of its agent types. For the Career Agency System, agent conduct has been addressed in the Agency Management Guide, the Field Compliance Manual and the Code of Business Conduct. All set forth and review Company policy with regards to appropriate actions and conduct. The Field Compliance Manual outlines sanctions that include: counseling, warning, letter of reprimand, fines, probation, suspension and termination. The Field Compliance Manual also outlines what steps will be taken to investigate suspected violations and indicated that a determination of the severity of the violation will be made and a determination of the applicable sanction made. Both the Agency Management Guide and Field Compliance Manual outline in detail actions that are considered inappropriate; however, they do not specify the procedures by which sanctions would be applied.

The Independent General Agency is vested, by Company contract, with supervisory duties for brokers appointed with the Company through the General Agency. The General Agency is required to follow the same procedures as outlined in the above referenced publications.

National Accounts, the investment firms and banks authorized to market the Company's products, were responsible for their representatives engaged in the sales of the Company's products. "The Company did not have formal agent disciplinary procedures with regard to the representatives retained by the national account firms. Pursuant to the terms of the form sales agreement, the Company retained the right to cancel the appointment of individual representatives of the national account firms."

When asked if the Company had an Ethics Review Board or similar entity the Company responded "The Company does not have an Ethics Review Board per se. Pursuant to the Company's Code of Business Conduct...the Company has established a process providing for the reporting of ethics related matters to personnel in our human resources, law and audit departments."

The Field Compliance Manual also references internal monitoring procedures; an Internal Audit Department to review and monitor Company operations and field office visits. Individual departments were also to "establish monitoring procedures to measure their own compliance performance..." When asked for the specifics of these programs and the results of the monitoring efforts the Company response indicated that these policies and practices were implemented outside the time period of the examination.

STANDARD 9 – The Company had and followed written procedures for disciplining agents and that actions were documented.

RESULT: The Company met this standard.

AGENT LICENSING & APPOINTMENTS

A random sample of 150 policy data files were reviewed to determine if the agent was both licensed and appointed at the time the application was written. The agent listed on the application was checked against the OIC's agent licensing system to identify any licensing or appointment irregularities. The examiner's findings are as follows:

- Twelve (12) agents were licensed but not appointed when 15 applications were written. This is a violation of RCW 48.17.010 and RCW 48.17.160(1).
- Two (2) agents were not licensed or appointed when two (2) applications were written. This is a violation of RCW 48.17.010, RCW 48.17.160(1), RCW 48.17.060(1) and RCW 48.17.060(2).

RCW 48.17.010 defines an agent as any person appointed by an insurer to solicit applications for insurance on its behalf. RCW 48.17.160(1) defines the Company's responsibility to appoint agents that represent the Company. RCW 48.17.060(1) and RCW 48.17.060(2) state that no person in the State of Washington will act or hold himself out to be an agent and that no person shall solicit or take applications for others any kind of insurance that he is not licensed to sell. The agents, policy numbers, application dates, and license and appointment status as of the application date are listed in Appendix A.

STANDARD 10 – Agents representing the Company had been licensed and appointed prior to soliciting applications on behalf of the Company, RCW 48.17.010.

Number of policies issued	2,280
Number reviewed	150
Violations	17
Percentage	11.3% (0 tolerance)

RESULT: The Company did not meet this standard.

The Company reported that one (1) Washington agent was terminated for “failing to comply with Sun Life policies and procedures.” This is consistent with OIC records.

STANDARD 11 – All agents that had been terminated for cause by the Company had been reported terminated to the OIC.

RESULT: The Company met this standard.

COMPLAINT HANDLING PROCEDURES/COMPLAINTS

The Company states that “Prior to 1997, employees were periodically advised about their complaint reporting responsibilities, and the Company’s Law Department was responsible for recording and tracking complaints, and maintaining the Company’s complaint register. Other than the complaint registers themselves, however, we have been unable to locate much in the way of historical documents relating to Law Department procedures during the examination period.”

In 1995, the Company established a dedicated business unit, the Customer Relations Department, to respond to customer complaints. Additionally, a “cross functional committee” was established to review complaints on a regular basis, usually weekly. Currently, the committee is comprised of representatives from Customer Relations, Compliance and Customer Service. The Company advises that in addition to resolving the complaints, the committee “conducts a root cause analysis of complaints so that corrective action may be taken to prevent similar complaints going forward.”

The Company provided their current, detailed complaint handling procedures with the comment that “Although these procedures may have changed somewhat since late 1995, they substantially reflect the Company’s complaint handling procedures during the latter part of the examination period.” These procedures include the definition and examples of complaints, how to properly document complaints, a Format Sheet and Complaint Record to document the complaint, and a Close-Out Sheet to document the final resolution. In addition, the Company has stressed that their complaint handling procedures continue to be refined. More sophisticated complaint tracking procedures have been developed, with the use of computer databases, to ensure that all complaints are handled on a timely basis.

STANDARD 12 – The Company had and followed written complaint handling procedures.

RESULT: The Company met this standard.

In summary, upon complaint file review, it was not possible to determine from the papers in the file if the Company followed the procedures outlined above. There was a general inconsistency in the format of the files reviewed and rarely was a Complaint Record or Close-Out Sheet, as referenced above, encountered. While the Company's current procedures do address tracking trends, the start date of this particular procedure cannot be determined with any degree of precision. However, that date was at some point during the exam period.

STANDARD 13 – The Company monitored complaint records for trends, and had a formal procedure for reporting trends to management.

RESULT: The Company met this standard.

The Company received a total of 43 complaints during the exam period. The Company's complaint log listed ten (10) types of complaints. A random sample of 28 complaint files was selected for review based on applicability to the scope of the examination. A breakdown of these complaints is as follows:

Type of Complaint	Source of Complaint	Corrective Action Taken	No Action Needed	Satisfactory Explanation
Agent/Broker Handling	Consumer	3	1	0
Commissions	OIC	1	0	0
Misrepresentation	Agent/Broker	2	0	0
	Consumer	10	0	3
	OIC	3	1	1
Policy Understanding	Consumer	2	0	0
Product Features	Agent/Broker	0	0	1
TOTALS	Agent/Broker	2	0	1
	Consumer	15	1	3
	OIC	4	1	1
	GRAND TOTAL	21	2	5

Of the 28 files reviewed, twenty (20) were classified as "misrepresentation." The additional eight (8) files requested concerned issues within the scope of the examination. Six (6) of these files listed their source as the OIC. Particular attention was given to these six (6) files to

determine if the Company had responded timely to the OIC within 15 business days as required by WAC 284-30-650. The Company acknowledges receipt of an OIC complaint within 15 business days. However, the standard response letter to the OIC states that the Company is “currently investigating the concerns expressed and will respond to you as soon as possible.” This reply to the OIC is inadequate and is in violation of WAC 284-30-650. Responses to the OIC must address every issue in the inquiry and include documentation to support the position of the Company.

There were a total of fourteen (14) OIC complaints during the exam period. Six (6) complaint files were a part of the random sample. Three (3) of the six (6) OIC complaint files were in violation of the 15 working day response requirement required by WAC 284-30-650. See Appendix B.

STANDARD 14 – The Company responded to OIC complaints within 15 business days (WAC 284-30-650) and showed good faith in resolving complaints within 15 business days.

Total number of OIC complaints	14
Policy files reviewed	6
Number outside of 15-day turnaround	3
Percent outside of 15 day turnaround	50% (outside 5% tolerance limit)

RESULT: The Company did not meet this standard.

REPLACEMENT PRACTICES

In response to the examiners’ request for copies of the Company’s replacement procedures, the examiners were provided with numerous memos and procedural documents. While not all were dated, the Company provided a narrative time line to show continuity in processing.

Communication to the field regarding the definition of replacements, cautionary statements regarding the appropriateness of replacements and the use of the proper forms for replacements appears to have been constant throughout the exam period. The earliest dated documentation is from the July 1990. The Agency Management Guide states “The primary purpose for Replacement Clause provisions is to insure THAT THE POLICYHOLDER’S BEST INTERESTS are being served. The policyholder should always be made aware of the possible financial and insurance losses that replacement usually involves.” This same document addresses the issue of commission adjustments in certain replacement situations.

Specific to Washington is a memo dated October 18, 1995 which advises that Washington replacement regulations apply to both internal and external replacements. This memo was distributed to branch agency managers. To further emphasize the importance of educating their sales staff on replacement requirements and regulations, the Company required all of its career agents and branch agency managers to complete the self-study Life Underwriting

Training Council course, Piecing Together the Ethical Puzzle. Completion of this course is a prerequisite to representing the Company in the marketplace.

The Company's internal processing procedures were also reviewed. An inconsistency with Washington regulations was noted in the 1995 Underwriting Department Replacement Procedures. These procedures state "Replacements are notification letters sent out to other insurance companies, they must be sent within 24 hours after receipt of the application, on an insured they have a policy on that may be replaced with a Sun Life insurance policy. We send out this letter so that the other insurance company can try to save their business. THE LETTER CANNOT BE SENT OUT UNTIL REPLACEMENT FORM IS REC'D." While it is noted that these Company procedures state that the letter "must be sent within 24 hours after receipt of the application," the final sentence in bold letters in the procedures would contradict the Company's 24-hour rule. In order to comply with WAC 284-23-455(2)(b), the replacement form must accompany the application.

A review of 150 randomly selected policy files from the Company **provided** database of policies issued during the exam period was conducted. Replacement was involved in 38 of the 150 files. The examiner's findings were:

- One (1) file did not contain a signed statement from the applicant as to whether or not the proposed application was intended to replace existing coverage. This violates WAC 284-23-450(2).
- One (1) file did not contain an agent's statement as to whether he or she knew that replacement might be involved. This is a violation of WAC 284-23-455(1).
- There were five (5) files that did not contain a copy of the replacement notice provided to the applicant. This is a violation of WAC 284-23-455(2)(a)(ii).
- There were five (5) files that contained copies of the replacement notices provided to the applicant. However, these copies were dated after the date of application. This is a violation of WAC 284-23-455(2)(a)(ii).
- In ten (10) instances, written communication to the existing insured was not completed within the three (3) working days of the date the application was received by the Company. Given the nature of the Company's policy files, it was not possible to determine the date the application was received at the home office, or to determine if the notification letter to the existing insurer was sent within the three (3) day standard. This is a violation of WAC 284-23-455(2)(b).
- The Company did not maintain a replacement log prior to September 1995. There were thirty-two (32) files in the sample involving replacement that were not listed on a replacement log. This is a violation of WAC 284-23-455(3).
- The Company began maintaining a replacement log in September 1995. There were four (4) that were not entered in the log. This is a violation of 284-23-455(3).

The specific files in violation are included in Appendix B.

STANDARD 15 – The Company’s replacement procedures were in writing and were consistent with the Washington Replacement Regulations.

Code	Total Population	Sample Size	# of Violations	% of Violations
WAC 284-23-450(2)	2,280	38	1	2.6%
WAC 284-23-455(1)	2,280	38	1	2.6%
WAC 284-23-455(2)(a)(ii) – Notice	2,280	38	5	13.2%
WAC 284-23-455(2)(a)(ii) – Date	2,280	38	5	13.2%
WAC 284-23-455(2)(b)	2,280	38	10	26.3%
WAC 284-23-455(3) – Prior to 9/95	2,280	38	32	84.2%
WAC 284-23-455(3) – After 9/95	2,280	38	4	10.5%

RESULT: The Company did not meet this standard.

Monitoring Replacement Activity

Note: There is no legal limit as to the number of replacements an agent may write. However, replacements should be monitored by the companies to guard against excessive replacement, or churning. The threshold of “greater than one (1) per month” is used in this section of the examination solely for the purpose of testing company oversight procedures.

The Company was asked to provide their registers for the entire examination period. They could only provide replacement registers dating from September 1995. The Company responded “the earliest date on the replacement register previously provided to you is September 1995. It appears that at that time, the September report was newly created.” The Company noted that given high employee turnover in that respective area during the time frame in question “We are unable to confirm whether replacement logs were kept prior to September 1995.”

The replacement registers for the period September 1, 1995 to December 31, 1996 were reviewed. There were 2,280 policies issued during the examination period. For the period September 1, 1995 to December 31, 1996, there were 263 policies issued. The Company’s replacement log for the period September 1, 1995 to December 31, 1996 contained 102 entries. This is approximately 38.8% of the Company’s business during this time period. Fourteen (14) agents, each of whom had written two or more contracts in any given month during this time period, were responsible for writing 61 of the contracts appearing on the replacement log (59%).

STANDARD 16 – Number of replacements for any one agent in any calendar year should not be significant (<1 per month, combined internal and external replacements).

RESULT: The Company did not meet this standard.

During the examination period, the Company's career agency branch managers were held responsible for monitoring day-to-day agent activity, including replacement monitoring. According to the Agency Management Guide section governing replacements, the field compensation department provided the branch managers with computerized listings that informed the branch manager of any replacement activity. Any excessive activity noted at that time was addressed with the agent by the branch manager.

STANDARD 17 – The Company had identified patterns of replacements by individual agents such as moving policies in and out of the Company at regular intervals, replacements of large blocks of business, moving funds from one policy to another.

RESULT: The Company met this standard.

Subsequent Event: Since the examination, the Company has developed replacement activity reports that allow for more focused review and monitoring. These reports are distributed to management personnel. Further, the Compliance Department conducts periodic file reviews based on data obtained from these activity reports in an effort to detect unusual trends.

POLICY FILE REVIEW

The number of Washington policies in force as of 12/31/96 was 6,281. The total number of policies issued in Washington from 1/1/92 to 12/31/96 was 2,280. From the total of 2,280 issued policies, 150 policy files were selected at random and requested from the Company.

The policy files were reviewed with emphasis on the following areas:

- Did both the applicant/owner and the agent properly sign the application?
- Was the agent appointed by the Company and licensed by the state when the application was signed?
- Was replacement of an existing contract involved and if so were the proper replacement forms completed? If an external replacement, was proper notification provided to the existing company?
- Were existing policy values used to pay the premium on the new policy?

The review of policy records did not indicate a pattern of old policies being used to fund new policies. The remaining specific findings of this review are incorporated into the sections of this report entitled Replacement Practices and Agency Licensing/Appointments.

REGULATORY ACTIONS BY OTHER STATES

A review of the disciplinary actions taken by other states within the last 5 years indicates two (2) actions. These actions are summarized below.

- 1) State of Florida, 1996 – The Company paid an administrative fine in the amount of \$17,000 and a reimbursement of \$2,000 for partial administrative costs to the Florida

Department of Insurance for use of advertisements in violation of Florida Insurance Code.

- 2) State of New Jersey, 1998 – The Company paid a \$2,000 fine to the New Jersey Department of Banking and Insurance for replacement violations relating to failing to verify the accuracy of information on the comparative information form and for failure to give notice within 3 days to the existing insurer.

SUMMARY

Since the examination period of 1992 – 1996 was a number of years ago, the Company did encounter some difficulty in producing documentation in certain instances. In addition, producing requested information was made more difficult by the fact that the Company has undergone substantial staffing changes at the supervisory and mid-management levels. However, the Company's candor and cooperation during the examination was instrumental in understanding the growth of the Company and the Company's desire to meet compliance standards.

During the examination period, the Company relied heavily upon the oversight provided by the Career Agency System. Realizing the need to maintain control over day-to-day business operations, the Company began strengthening its compliance efforts during the latter part of the examination period. The Company maintains a Compliance Department with extension training and experience in a wide variety of areas. These areas include insurance and securities regulatory matters, advertising, sales practices, illustrations and policy form filing. The Compliance Department also is instrumental in developing policies and procedures that comply with existing regulations and standards. The Compliance Department, in conjunction with the Law Department, monitors changes to state and federal laws and regulations governing the company's business operations. The Company's Internal Audit Department supports the compliance program through periodic testing and review of company policies, procedures, and control systems.

Subsequent to the time frame of this examination, the Company appears to have strengthened their written procedures. If a current exam were to be done, one would hope that the current practices would be consistent with the currently documented procedures.

INSTRUCTIONS

- 1) The Company is in violation of RCW 48.17.010 and is instructed to make certain all agents are licensed and appointed by the company with the State of Washington prior to soliciting applications on behalf of the company. (Page 13).
- 2) The Company is in violation of WAC 284-30-650 and is instructed to respond to the OIC within 15 business days and to include sufficient supporting documentation with their response. (Page 15).
- 3) The Company is in violation of WAC 284-23-450(2) and is instructed to “Require with or as part of each application for life insurance or annuity a statement signed by the applicant as to whether such proposed insurance or annuity will replace existing life insurance or annuity.” (Page 16).
- 4) The Company is in violation of WAC 284-23-455(1) and is instructed to “Require with or as part of each completed application for life insurance or annuity, a statement signed by the agent or broker as to whether he or she knows replacement is or may be involved in the transaction.” (Page 16).
- 5) The Company is in violation of WAC 284-23-455(2)(a)(ii) and is instructed to “Require...a copy of the replacement notice provided the applicant pursuant to WAC 284-23-440(2)(a). (Page 16).
- 6) The Company is in violation of WAC 284-23-455(2)(a) and is instructed to make certain that the notice is completed no later than at the time the application is taken. (Page 16).
- 7) The Company is in violation of WAC 284-23-455(2)(b) and is instructed to “Send to each existing insurer a written communication advising of the replacement or proposed replacement...” (Page 16).
- 8) The Company is in violation of WAC 284-23-455(3) and is instructed to maintain a replacement register. (Page 16).
- 9) The Company is in violation of WAC 284-23-455(3) and is instructed to change its procedures to make certain all replacement business is entered on the Company’s replacement register. (Page 16).

RECOMMENDATIONS

- 1) It is recommended that the Company maintain audit records demonstrating review of agent or vendor produced training materials. (Page 7).
- 2) It is recommended that the Company maintain audit records demonstrating review of agent activity through regular visits to their agents. (Page 9).
- 3) It is recommended that definitions and compliance issues also be noted in the Company's Spirit Software Tutorial as prominently as they were in the Field Compliance Manual. (Page 10).
- 4) It is recommended that the Company, consistent with its stated procedures, place a complaint status sheet in each complaint file so that the progress of the complaint and its resolution may be tracked and reviewed without having to reach each document in the file. (Page 13).
- 5) It is recommended that the Company establish a practice of clearly date stamping the application when it is received in the home office. (Page 16).

**APPENDIX A
AGENT LICENSING AND APPOINTMENT VIOLATIONS**

AGENT #	POLICY #	APPLICATION DATE	LICENSED	APPOINTED
Lapito, Leo B.	9256216	01/20/92	Yes	No
Oliver, Richard B.	9280527	10/28/92	No	No
Levitan, Yaron	9299414	10/25/93	Yes	No
Smith, Robert S.	9245895	09/20/91	Yes	No
Dunham, Michael	9281590	02/17/93	Yes	No
Martin, Paul	9293166	08/16/93	Yes	No
Wheeler, Bret	9301434	12/02/93	Yes	No
	9302133	03/10/94	Yes	No
	020002875	10/30/95	Yes	No
Stefoni, Daniel	UB8142537	06/21/93	No	No
McGlocklin, Gerald	010006711	10/10/94	Yes	No
	020017206	01/11/96	Yes	No
Meisenbach, John W.	020006695	07/29/95	Yes	No
Lozan, Helen	020019424	06/08/96	Yes	No
Coen, Robert W.	020023318	07/19/96	Yes	No
Craddock, John G.	020027038	09/26/96	Yes	No
Mori, Robert	020026335	06/28/96	Yes	No

APPENDIX B**COMPLAINT RESPONSE VIOLATIONS – MUST RESPOND TO OIC WITHIN 15 BUSINESS DAYS**

POLICY NUMBER(S)	RECEIVED AT COMPANY	COMPANY RESPONSE TO OIC	BUSINESS DAYS TO RESPOND TO OIC
9220183, 9220188	10/24/94	12/29/94	48
9240648, UB8131091, 5338296, 1895348, 5139281, 5214427, 5312085, 5362582, 5392642	09/11/95	10/18/95	27
5934059	04/04/95	05/16/95	30

**APPENDIX C
REPLACEMENT VIOLATIONS**

Code/Description	# of Violations	Policy Number(s)
WAC 284-23-450(2) – Replacement, submit statement signed by applicant	1	022017572
WAC 284-23-455(1) – Replacement, submit statement signed by agent	1	9302133
WAC 284-23-455(2)(a)(ii) – Replacement, require copy of replacement notice	10	9283922, 9299414, 010007654, 010007689, 020012305, 9268263*, UB8137933*, 020002875*, 020007866*, 020022299*
* Notice dated after date of application		
WAC 284-23-455(3) – Replacement, maintain replacement register (Prior to 9/95)	32	9259194, 9282854, 9283922, 9287941, 9288071, 9289140, 9299414, 9310267, UB8134613, UB8134726, UB8136770, 9249443, 9264985, 9268263, 9270032, 9271554, 9293190, 9296575, 9307343, 9307743, UB8131283, UB8135877, UB8137933, UB8143234, UB8144087, 010007654, 010007689, 010007843, 020005970, 020007866, 020007942
WAC 284-23-455(3) – Replacement, maintain replacement register (After 9/95)	4	022012305, 022017206, 020022299, 020026335